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The Asymmetric Benefits of Globalization

By Pan A. Yotopoulos

Globalization, as it is broadly defined, highlights the increased connectivity and interdependence of the world's markets, businesses, and even cultures. The outcomes of globalization have been pronounced, on balance, positive although this balance is strongly disputed by the detractors of globalization. The operational formulation of the institutional setting of globalization rests on the universal adoption of a common set of "rules of the game" for economic interactions in the form of "free-markets, free-trade, laissez-faire" (FM-FT-LF), alias known as the "Washington Consensus."

While the catchwords of globalization and Washington Consensus are certainly new, the phenomenon is not. The first wave of globalization

transpired, roughly, from 1870 to 1914, while the current one started in the 1980s and is going strong today. Both globalization waves were fuelled by drastic reductions in transport costs, which in the case of the 19th century globalization were the result of the revolution in marine transportation and the invention of ocean faring refrigeration. The global connectivity of the current globalization has been enabled by the technological advances of the 20th century and the ease of transportation, communication and transmission of information that amount to "the death of distance". Moreover, in both cases the regulatory barriers to trade were adroitly demolished.

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About The Author

Pan A. Yotopoulos was appointed Professor at Stanford (Food Research Institute) in 1968 and he took early retirement in 2001. Since then he has been a Distinguished Professor ("Chiara Fama") at the University of Florence and SCID Scholar at SIEPR, dividing his time between Italy and Stanford. He has done research and taught in the fields of Economic Development, Agricultural Economics, Demography and International Trade and Finance. His current interest is in Globalization and especially its impact on developing countries. His latest book is *The Asymmetries of Globalization*, London and New York, 2007 (co-edited with Donato Romano). This SIEPR Brief draws on the theme-setting introductory chapter of that book.



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The differences in the comparison of the two globalizations lie mainly in the initial conditions. At the beginning of the first wave the world was fairly homogeneous, homogeneously poor and agrarian. At the beginning of the second wave the world was sharply divided between rich industrial nations and poor primary producers. As for the final outcomes, the early globalization ended up in industrializing the North and de-industrializing the South. What is the likely ending scenario for the current wave of globalization?

In approaching the question, the analytical focus of this paper will be the ongoing configuration of international trade around “services”, in contrast to the 19th century globalization that dealt exclusively with trade in commodities. The novel element that this paper introduces is the expansion of the category of services to include also goods that enter international trade enshrined with reputation (“decommodified goods”).

Asymmetries Based on Institutional Infrastructure

Adam Smith, the first and arguably the most enthusiastic

advocate of free markets, made it abundantly clear that markets need all the help they can get in order to perform as intended. He properly emphasized the important role of the state in providing defense for its citizens with an army, security with a police force, justice with a court system, plus whatever we would currently call “good governance.” He especially noted the need that the state provides the “institutions for facilitating the commerce of society,” like roads, bridges, and ports. Today the most basic Smithian infrastructure would probably include, among others, a high-speed venue of telecommunications infrastructure, telematics technology, plus the requisite transport infrastructure for the movement of people, merchandise, documents and ideas.

An important, and certainly not new, message of this essay is that globalization is *institution-laden* and its success is predicated on the presence of some key institutional parameters. Institution building, however, becomes an expensive proposition that comes easier in the richer countries while most

poor countries can ill afford it. To say the least, free trade and free markets, although they may often serve as drivers to growth, they are certainly not the silver bullet and the “up-by-the-bootstraps” cure-all for the developing countries.

Trade in Commodities and Trade in Services: Another Asymmetry

Comparative advantage trade in commodities is still an important part in the current round of globalization – after all, it is the “secret weapon of mass destruction” that China possesses. What is new in the contemporary scene is the trade in services. It first featured as a significant component of international trade in the 1980s and has by now become the tail that wags the international trade dog – at least as it relates to the asymmetries of mutual advantage trade. International trade in commercial services – consisting of transportation, communications, insurance, financial services, royalties, license fees and copyrights – grew from US \$400 billion in 1986 to US \$2500 billion in 2005, a six-fold increase in 20 years. In parallel, the share of commercial services in total WTO international trade (exports) has in the



interim grown from 17.5% to 23% by 2005 (WTO, 2006).

The economics literature highlights the germane characteristics of trade in services as distinct from trade in commodities. Commodities are fungible, in the sense that wheat is wheat. They can be stored, transported and accumulated. Services, on the other hand, are intangible and not fungible – surgery by different doctors is not the same. Services are instantaneous (in that they perish in the very instant of production) and therefore involve the interaction of the consumer with the provider – which can take any form in a continuum from face-to-face to arm’s length interaction. Services are ordinarily more “customized” than commodities: they do not have any generic substitutes. Services also ordinarily involve some amount of *trust* (or reputation).

Thus trade in services is distinguished from trade in commodities by two characteristics that are interactive and lead to a premium and *economic rents: customization and trust*. The customization component is often sheltered by intellectual property rights that generally

enjoy legal protection and have more recently been endowed with WTO global recognition and enforcement. Customization and trust register in the market place in terms of reputation, which in turn makes the specific market less contestable.

The Economic Rents of Decommodification

Customization and trust, in one word “reputation,” create profits, but trade in commodities can also be partly founded on reputation by “moving up the value-added chain” in order to deliver economic rents. “Decommodification” lies in between the two extreme of pure commodities and pure services. That huge band of decommodified trade involves to a lesser or greater degree customization and trust. Examples of such decommodified trade are Kona coffee, the Hilton Hotels, or Business Class air fare. This entire sector of “decommodified” trade is missing from the WTO data-base of trade in “commercial services” mentioned earlier. The 23 percent share of commercial services in total world trade suffers, as a result, a serious statistical undercounting.

Reputation-based decommodified trade is a distinctly

different category from the price-competition based trade. Within the continuum of customization a good is traded at a price that reflects its cost of production, a dollar amount, which is enhanced by a component of the “reputation payoff” to determine the market price of the decommodified good. When a Fortune 500 multinational corporation sets shop in a developing country, it attracts its clientele not because it has a comparative advantage, but primarily because of its reputation as having been successful: being more reliable, being better-capitalized, having better corporate governance, in other words for having a better “*brand name*”. Developed countries are better situated to engage in decommodified trade in general and to provide services in specific, and thus to capture the economic rents that accrue to reputation. The reason is that reputation in the international arena is most often the sinecure of wealth and power and it is nourished by visibility, three characteristics that are found more readily in the developed countries. It is easier for the developed countries to market the reputation that they have already gained than it is for poor countries that have first to create the reputation from scratch.

The extreme case of the asymmetric trade arises when *network effects* are bundled in the provision of a service, resulting thus in a winner-take-all situation. This happens in a wide range of services, from telephony, to information technology, to banking and insurance. Network effects create systematic winners in the developed countries, to the detriment of a swath of service sectors in the developing world. It is not so much the cost advantage or the quality of service as it is the network effect that has Bank Megara Indonesia and Star Insurance Malaysia on the ropes when the Bank of America and Lloyds Insurance move in under the services liberalization protocol of the WTO. It is all the more surprising that this huge systematic asymmetry in outcomes was signed away in 1996 in Singapore by the developing countries without any reciprocal concessions from the developed world.

Outsourcing and Other Trade in Commodified Services

Trade competition in services is a competition in which developing countries are bound to be the losers overall,

as long as developed countries have the advantage that earns a reputation payoff in international trade. This is not to deny that some developing countries earn substantial parts of their foreign exchange by exporting tourism and others by exporting service-provider workers. More often than not, however, the mass tourism in developing countries becomes commodified to the lowest common denominator of “back-pack” tourism. Similarly the export of service workers from poor countries captures little in economic rents, since their paychecks are largely based on arbitraging the minimum wage between developed and developing countries.

One type of export of services that does not fit the mold I have been casting is the much celebrated outsourcing of services relating to information technology and back-office support that is being directed from the developed countries to India and China in recent years. This is a type of Ricardian comparative advantage trade that delivers mutual benefits, although maintaining superiority in “endowments” is mandatory for the developed countries in order to preserve their lion’s share of the gains of the outsourcing trade

that they enjoy.

While the classical paradigm of comparative advantage “fails” in the case of “similar endowments” that Samuelson (2004) poses, the neoclassical literature feigns reassurance that the developed countries will continue to capture the economic rents of decommodification by shifting to new sectors for which they are abundantly endowed. Tangible exhibits of this “trade in similar products” or “trade in variety” are the Ermenegildo Zegna, Calvin Klein and Kenzo that one encounters on Madison Avenue in New York and at the upscale shopping malls of many a developing country. On the other hand, the same evidence can be treated as a handy confirmation that the asymmetries of globalization are systematic and as long as they are ensconced in “dissimilar reputation,” the benefits from the largesse of the elites of both the developed and the developing world will continue being captured asymmetrically by the developed countries.

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Epilogue: Globalization and the Divide of Inequality within Countries

This brief focused mainly on the increasing divide that separates rich and poor countries in this era of globalization. A fleeting first look at the within-country inequality suggests that both the poor and the rich within a country should benefit since they are consumers of the goods purveyed by globalization at bargain prices.

This may be true for the poor in developing countries if their jobs are sustained by an increase in commodity exports in globalized trade. It is certainly not true for the poor in the developed countries if they are the ones who were previously employed in the production business of the one-dollar Chinese blouses, when these were produced locally, at the textile factories of South Carolina or those of Toscana in Italy. These jobs in the local industry were paying decent wages and they were feeding the workers' dreams of stepping on the escalator that would propel them from poverty to the middle income classes. With globalization these jobs have disappeared

and the unemployed have lost their wage checks. By not being producers any more, they can no longer afford the consumers' cornucopia and the one-dollar blouses that globalization offers.

The rich, on the other hand, run no risk of losing their jobs to imports nor do they face an income constraint since they have wealth, whether they live in the developed or in the developing countries. The latter, especially, profit from the cheap commodities of globalization trade, but mainly they profit from the freedom to import the decommodified standards of living of their rich brethren in the first world. Their graduation from consumers in the third world, where they live, to first-world consumption levels, in terms of what imports they can afford to buy, has become the problem of the Central Bank that finds its international reserves depleted by the economic imbalance of producing like a poor country and consuming like the rich!

Although this brief has focused on the risk that globalization becomes the epitaph of growth in the third world, the increasing divide between the rich and the poor within countries, be they

developed or developing, may prove even more ominous for the future of globalization itself. Unless the gains from free trade are shared more equally between rich and poor countries, and among the rich and the poor within them, the future of this second globalization may be short-lived.

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